No. 8832.

In the United States Circuit Court of Appeals

For the Ninth Circuit.

In the Matter of
C. S. HUTSON & COMPANY,
Bankrupt.

C. S. HUTSON,
Appellant,

vs.

S. J. COFFMAN, Trustee in the matter of C. S. HUTSON & COMPANY, Bankrupt,
Appellee.

APPELLANT'S OPENING BRIEF.

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APPELLANT'S OPENING BRIEF.

Statement of Jurisdiction.

The District Court had jurisdiction over the subject matter herein involved by reason of the fact that a proof of unsecured debt was filed in the matter of C. S. Hutson & Company, Bankrupt [R. 4], and the Trustee for the bankrupt estate filed his objections to the said claim [R. 6], and the Referee made his order disallowing the claim [R. 7], and the Referee filed his certificate on review [R. 9; Bankruptcy Act, Section 2, Subdivision 10; 11 U. S. C. A., Section 11, Subdivision 10], and the District Court made its order denying petition for review

[R. 11], and made its order denying petition to reconsider [R. 13], and C. S. Hutson filed his petition for appeal [R. 57], and the order was granted allowing appeal. [R. 57.]

This Court has jurisdiction of this appeal, this being an appeal from a judgment allowing or rejecting a claim of five hundred dollars or over (Bankruptcy Act, Section 25), and this Court has jurisdiction (Bankruptcy Act, Section 24-B; 11 U. S. C. A., Section 47-B).

An appeal was allowed by the District Court on a petition for appeal on July 23, 1937.

Statement of the Case.

C. S. Hutson, the appellant herein, duly filed his proof of unsecured debt before the Referee in the sum of $7400.54 [R. 4], and S. J. Coffman, Trustee of the bankrupt estate, duly filed objections to the allowance of said claim, and a hearing was had before Hugh L. Dickson, Referee in Bankruptcy, on said proof of claim on April 12, 1937. [R. 7.] The Trustee's objections were based on three grounds, as follows:

> "1. That the records of said bankrupt are incorrect in that the true records of the bankrupt show that it is not indebted in any sum whatsoever but that you are indebted to the corporation in a sum in excess of $25,000.00.
>
> "2. That your purported claim arises out of fictitious sales of property and corresponding book entries therefor, wherein you attempted to sell to the bankrupt a one-fourth interest in the American Bank Check Company, receiving credit on *you* personal account for $25,000.00 although having no in-

terest in said company to sell and no evidence thereof ever delivered to the bankrupt.

"3. Fictitious entries of salary to H. L. Hutson since 1928, the credit thereof having been applied to your personal account."

The Referee made his order disallowing the claim of C. S. Hutson on April 13, 1937 [R. 7], and the Referee filed his certificate on review on April 16, 1937 [R. 9], and the Honorable George Cosgrave, District Judge, filed his order denying the petition for review on June 24, 1937. [R. 11.] C. S. Hutson filed a petition to reconsider the petition for review in the District Court [R. 12], and the District Court made its order denying said petition. [R. 13.]

The Trustee called a Mr. Goslin, who was the former auditor for the bankrupt corporation. He was the only witness who testified. The witness testified that on December 29, 1929, he found an entry in the sum of $6,371.19 which was credited to Mr. C. S. Hutson's personal account and charged against the salary of H. L. Hutson. [R. 34.] The witness testified that the journal entry gave Mr. Hutson a credit of $6,371.19, and a charge against H. L. Hutson of $10,290.29 [R. 36], and that H. L. Hutson was the father of C. S. Hutson. [R. 37.] There was no journal explanation of these items. [R. 37.] He testified as follows:

"There was some kind of a thing between the American Bank Check Company, who owed the company money, and Mr. H. L. Hutson, who he had on the pay roll. It was an old mixed up account, I couldn't tell you how many years it went back. He decided to wipe it out. In other words, he credited

his account and credited himself, and let it go at that.

By Mr. Myers:

Q. What was the balance of that $10,000 credit? A. Then we credited the American Bank Check Company for $3,919.10.

Q. And $6,371.19 to Mr. C. S. Hutson's personal account? A. Yes.

Q. Who owed the account of ten thousand two hundred some odd dollars, what was that against? Who had the credit for that amount of money? A. H. L. Hutson. That's my recollection of it.

Mr. Powell: That's what the books say, isn't it? A. Yes." [R. 37-38.]

The witness testified that on December 17, 1929, the American Bank Check Company sold to C. S. Hutson & Company an 18% interest in the American Bank Check Company for $18,000, and the $18,000 was charged to the investment account as a credit in the sum of $18,000, and represented an 18% interest in the American Bank Check Company, and the $18,000 was then credited to C. S. Hutson, there being a credit of $10,100 to the open account of C. S. Hutson, and $7,900 on his notes receivable account. [R. 40.] This transaction was approved by the board of directors of the company. [R. 40.] The witness testified that on December 31, 1929, H. L. Hutson had a credit with the company of $10,290.29, and that this amount plus the item of $10,000 gave him a credit balance on the books [R. 41]; that the credit of H. L. Hutson was a credit brought up from back salaries, plus other monies [R. 43], and that this back salary was removed from the books by crediting three thousand and some odd dollars to the American Bank Check Company, and $6,371.19 to C. S. Hutson's personal account. [R. 43.]

In April, 1930, there was a charge of $7,000 to the investment account of the company and a credit to C. S. Hutson for $7,000 to record purchase from C. S. Hutson of an additional 7% interest in the American Bank Check Company, making a 25% interest in all. This was approved by a resolution of the board of directors. [R. 44.] Mr. Goslin testified that on August 21, 1934, C. S. Hutson was charged with the sum of $3,500 [R. 47], and his personal account was charged with the sum of $3,500. [R. 48.] The Trustee, through his counsel, stipulated the the books of the corporation as of the close of business March 1, 1934, reflected that the corporation was indebted to C. S. Hutson in the sum of $7,400.54 [R. 51], and that the C. S. Hutson Company had a 25% interest in the American Bank Check Company. [R. 51.]

After the introduction of this evidence the witness was excused and the following took place:

> "The Referee: This claim will be disallowed in toto.
>
> Mr. Powell: Can I ask the court, disallowed on the evidence that has been rendered here today?
>
> The Referee: Yes.
>
> Mr. Powell: I take exceptions." [R. 52.]

Subsequently, the Trustee, through his counsel, made a motion to introduce the general ledger for 1929, 1930, 1931, 1932, 1933, and 1934, and the journal entry with respect to the items on which the witness was questioned. He also moved to introduce as evidence the transcript of H. L. Hutson's testimony in San Francisco under an order of special reference. [R. 52, 53, 54.] Objections were made to the introduction of the books on the ground that they had already been examined, and on the further

ground that testimony had already been introduced concerning the contents of the books. The books were allowed to be introduced and an exception allowed to C. S. Hutson. [R. 53, 54.] Then the following took place:

> "Mr. Myers: I also desire to introduce in evidence a reporter's transcript of the testimony of H. L. Hutson, taken before Bertram W. Wyman, special master in bankruptcy, in the matter of C. S. Hutson, a bankrupt, No. 23748, at San Francisco, September 17, 1936.
>
> Mr. Powell: Objected to as incompetent, irrelevant, and immaterial; there has been no showing that this proceeding taken before the Special Master Wyman has any bearing on the present objection to the claim, and on the further ground that C. S. Hutson was not present at said hearing, nor was his counsel, and on the further ground that no notice of the hearing of the taking of the testimony was given to C. S. Hutson.
>
> Mr. Myers: May we have a stipulation, Mr. Powell, that Mr. Hutson actually knew of the hearing and was actually present in San Francisco, but not in the hearing room?
>
> Mr. Powell: I think that's immaterial.
>
> The Referee: Objection overruled and exception will be allowed. You may have an exception.
>
> Mr. Powell: I will take my exception to that, and also my exception to the order of the court heretofore made.
>
> The Referee: That is all." [R. 54.]

Assignments of Error.

The assignments of error relied upon on this appeal are numbers 1, 2, 3, 4, 5, and 6. [R. 60, 61.]

ARGUMENT.

I.

The Referee and the District Court Erred in Allowing the Transcript of Proceedings Held in Ancillary Proceedings in San Francisco to Be Introduced in Evidence.

The argument under this heading is addressed to the following assignments of error:

2. The Court erred in allowing evidence to be introduced in the form of a transcript of proceedings held in ancillary proceedings in San Francisco, said proceedings not having been brought on in the presence of C. S. Hutson or his counsel, and having been brought on and maintained with no notice having been given to the said C. S. Hutson.

3. The Court erred in considering facts which were not a part of the record of the proceedings.

5. The Court erred in disallowing objections made to the introduction of evidence.

6. The Court erred in not following the rules of evidence and allowing the introduction of inadmissible evidence.

On October 20, 1936 the Trustee in bankruptcy filed his objections to the claim filed by C. S. Hutson. [R. 6.] Prior to this and on September 17, 1936, a hearing was had in ancillary proceedings before Bertram J. Wyman, as special master, in the matter of C. S. Hutson & Company, bankrupt. (The transcript is entitled, "In the Matter of C. S. Hutson," but this is obviously a typographical error. The transcript also reflects as follows:

"Messrs. John L. McNabb and S. C. Wright, attorneys for C. S. Hutson and American Bank Check Company." This also is obviously a typographical error and should be read as C. S. Hutson & Company.) There were no issues before the Court on the examination concerning the claim filed by C. S. Hutson, as no objections had been filed prior to that date by the Trustee. It was merely an examination of witnesses under Section 21-A of the Bankruptcy Act. It should be remembered that this testimony was not taken for use as a deposition, but merely as an examination to aid the Trustee. It should also be noticed that the transcript is unsigned by either the witness, the special master, or the reporter. The Referee decided this matter before the transcript was offered in evidence. Subsequently the case was reopened and the transcript offered in evidence over the objection of claimant. [R. 54.] After this decision and after the offer to introduce the transcript the following took place:

> "Mr. Powell: If this pertains to the proceedings already decided, we object to that as it has already been decided, and I have already noted my exceptions to the court's order.
>
> The Referee: Mr. Powell, as I said a while ago, I can't disabuse my mind of all the facts in this case. This deposition was taken up there, I think, under an order made by me, and it is part of these proceedings, this whole bankruptcy proceedings. I don't see how I can wipe it from my mind. I am going to permit the filing of that." [R. 52.]

Clearly this transcript was inadmissible, and should not have been considered by the Court.

Taylor v. Nichols, 134 App. Div. 787, 119 N. Y. Supp. 1042, 23 A. B. R. 310:

> "These schedules and part of the evidence so given by him in the bankruptcy proceeding were offered in evidence by the plaintiff upon the trial for the purpose of establishing the insolvency of the said Nichols at that time. To this offer the defendant objected, that as to him they were hearsay and that he was not bound by these declarations. The objections were overruled, the evidence was admitted, and the defendant excepted to the ruling. We are unable to see upon what ground this evidence was competent. It was the declaration of a bankrupt in a proceeding in which it does not appear that this defendant was a party. As to this defendant the evidence would seem clearly to be hearsay and inadmissible."

In the *Matter of National Boat & Engine Company,* 216 Fed. 208, it was held:

> "Upon a proceeding before the Referee for the distribution of the fund derived from the sale of the bankrupt's assets free from liens, testimony of the former president of the bankrupt company taken on a general examination under Section 21-A of the Bankruptcy Act and not directed to any definite issue is inadmissible in support of a claim."

Also see *Breckons v. Snyder,* 211 Pa. 176, 15 A. B. R. 112, 60 Atl. 575, in which it was held:

> "The notes of the testimony of the bankrupt, taken at a preliminary proceeding before the referee, to ascertain his assets and liabilities, were properly rejected. The issue was not between the same parties, nor did it involve the same subject matter."

Also see *In re Hersey,* 171 Fed. 1004, which holds that testimony taken at meetings of creditors, which the claimant did not attend and of which he received no notice, is not admissible upon the hearing of a claim.

II.

The Court Erred in Disallowing tht Claim in the Sum of $7400.54.

The argument under this heading is addressed to the following assignments of error:

1. The Court erred in disallowing the claim in the sum of $7,400.54.

It is contended by the Trustee that the record reflects that on August 21, 1934, the claimant collected the sum of $3,500.00 and applied it on the indebtedness due him from the bankrupt company. There is no evidence that on August 21, 1934, the company was insolvent or that the claimant knew or had reasonable cause to believe that the company was insolvent. Therefore, the Trustee cannot contend that a preference existed under the terms of Section 60, Subdivision B, of the Bankruptcy Act. This section provides as follows:

> "If a bankrupt shall have procured or suffered a judgment to be entered against him in favor of any person or have made a transfer of any of his property, and if, at the time of the transfer, or of the entry of the judgment, or of the recording or registering of the transfer if by law recording or registering thereof is required, and being within four

months before the filing of the petition in bankruptcy or after the filing thereof and before the adjudication, the bankrupt be insolvent and the judgment or transfer then operate as a preference, and the person receiving it or to be benefited thereby, or his agent acting therein, shall then have reasonable cause to believe that the enforcement of such judgment or transfer would effect a preference, it shall be voidable by the trustee and he may recover the property or its value from such person. And for the purpose of such recovery any court of bankruptcy, as hereinbefore defined, and any State court which would have had jurisdiction if bankruptcy had not intervened, shall have concurrent jurisdiction."

The Trustee contends that a 25% interest in the American Bank Check Company was sold to the bankrupt by the claimant for the sum of $25,000.00, and that this last mentioned amount was credited on the books of the corporation, giving him a credit in the sum of $25,000.00. This 25% transaction took place on two different dates. On December 17, 1929, an 18% interest in the American Bank Check Company was sold to the bankrupt by the claimant [R. 40], and in April, 1930, a 7% interest was sold to the bankrupt by the claimant. [R. 44.] These two transactions were approved by the board of directors of the bankrupt. [R. 40, 44.] The bankruptcy proceedings were instituted more than three years after the last transfer of the 7% interest. There is no evidence in the record that any fraud was perpetrated on the creditors of

the bankrupt estate or that any creditors existed prior to the transfer of the 25% interest. Any rights that the bankrupt or its Trustee might have had have been destroyed by the Statute of Limitations. The applicable Statutes of Limitations are Sections 335 and 338:4, Code of Civil Procedure of the State of California, which provide as follows:

> Section 335: "The periods prescribed for the commencement of actions other than for the recovery of real property, are as follows:"
>
> Section 338: "Within three years:
>
> "4. An action for relief on the ground of fraud or mistake. The cause of action in such case not to be deemed to have accrued until the discovery, by the aggrieved party, of the facts constituting the fraud or mistake."

These sections of the Civil Code of Procedure are cited although it is respectfully contended that there is no evidence whatsoever of any fraud even though the transcript of the proceedings taken in San Francisco is considered.

The Trustee contends that fictitious entries of salary to H. L. Hutson were made after 1928, and that this salary was credited to the personal account of C. S. Hutson. The only evidence concerning this is found in the transcript [R. 37, 38], in which it was stated by Mr. Goslin, the bookkeeper, that H. L. Hutson had a credit on the books of the corporation in the sum of ten thousand some odd dollars. Even if it can be considered that the

transcript taken in San Francisco throws any light on this situation any rights that the bankrupt or its trustee may have had are entirely destroyed by Section 335 and Section 338 of the Civil Code of Procedure of the State of California above quoted.

Conclusion.

The only evidence before this Court is that the books of the bankrupt reflect that the claimant, C. S. Hutson, has a claim against the corporation in the sum of $7,400.54. [R. 51.]

Appellant respectfully prays that the order appealed from be reversed and that the claim filed by C. S. Hutson be allowed in the sum of $7,400.54, and for such other relief as may be just and equitable.

Robert B. Powell,

Attorney for Appellant.